TAX FOUNDATION
O F H A W A I I

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CITY CLERK
HONOLULU, HAWAII

The Honorable Ann Kobayashi, Chair
City Council Budget Committee
City & County of Honolulu
Honolulu, Hawaii 96813

Re: Various proposals to provide relief from the real property tax including: Bills based on Income, Bills 66, 80, 82 of 2005 and Bills 3, 4, 10, 15 of 2006; Bills based on Length of Residency including Bills 5 and 81 of 2005 and Bill 5 of 2006; Bills providing Broad-based Tax Relief including Bill 67 of 2004, Bill 1 of 2005 and Bills 1, 2, and 12 of 2006.

Dear Chair and Committee Members:

Thank you for the opportunity to share our observations and comments on the various tax relief measures you have before you this morning. As the Chair has strategically grouped these measures by relief mechanism, we would like to provide comments on all measures listed with a short digest and commentary on each and remain available to respond to questions about the various measures.

Tax Relief Based on Income

Of all the measures proposed for tax relief, these based on the ability to pay are the most valid for your consideration as they take into account the taxpayer's available resources in meeting his or her tax obligations. These measures do not violate the nature of the real property tax which is to base the tax on the value of the asset which in all of these measures is the taxpayer's shelter.

Bill 66 (2005) would require the re-application for the claim for the "super" home exemption for persons over the age of 75 and with low income to be submitted every five years.

> ***Comment: While this measure merely requires the taxpayer to reapply for the "super" home exemption every five years, we remain concerned that the process to ascertain whether or not the real property tax imposes an undue burden is overly complicated and does not necessarily relieve the elderly taxpayer of the undue burden as the amount of the home exemption may be insufficient to adequately bring the ultimate tax bill to within reason of the taxpayer's available resources to pay his or her property tax.***

Bill 80 (2005) would raise the income ceiling for persons who might be eligible for the City's circuit breaker program from $50,000 to $75,000.

Misc. Com. No. 0176

Comment: Of all the measures heard today, this is the most effective means of providing tax relief to those most in need of tax relief. It measures the real property tax burden against the resources of the taxpayer and excuses anything in excess of the 4% trigger. Thus, persons with the proposed maximum allowable income of $75,000 would never pay more than $3,000 a year in real property taxes. Consideration might be given to implementing this new version of the circuit breaker for the fiscal year 2007 tax bills. This would then necessitate new deadlines for the filing of an application for the circuit breaker.

Bill 82 (2005) would grant a one-time tax credit of an unspecified amount against a home owner's real property tax for the fiscal year 2007 provided the owner's household income did not exceed the median income and the homeowner, or any member of the household, did not own any other property and the property was qualified for the home exemption.

Comment: While this proposal might appear to address the problem of higher tax bills, the amount of the credit versus the size of the tax bill may be incongruent, that is the amount of the tax credit may not be enough to offset the larger tax bill created by the higher assessment. Again, this is a one-time tax credit and does not address the ongoing problem of rising assessments and therefore rising tax bills.

Bill 3 (2006) would reduce the assessment of a property that is rented as a low-income rental upon petition by the owner. The proposal would totally exempt rental property - except for the amount of the minimum tax - that participates in the Section 8 program from real property taxes for the next tax year upon petition by the owner.

Comment: This proposal ignores the behavior of the rental market. When rental supply is tight, rental rates will be dictated by the demand for those rentals. The burden of the property tax can be recovered in a tight rental market which is already happening. More importantly, this measure imposes an additional burden on the treasury and the real property division or whomever is tasked with verifying the amount of rent being charged or whether or not the landlord participates in the Section 8 program. To the extent that the City will still need the same amount of money to run county government, the exemption for section 8 rentals and the reduction in the assessment of low-income rentals by 20% shifts the burden of taxation to all other real property taxpayers who are the owners of such rentals. Thus, those landlords and certainly their tenants enjoy all of the City services at the expense of all other real property taxpayers.

Given that this measure is the only one that attempts to address low-income renters, as an alternative, consideration might be given to establishing a "circuit breaker" type of mechanism for low-income renters. A national group which monitors affordable rental housing reports that no more than 30% of a renter's income should go for shelter costs. Consideration might be given to extending a credit equal to the value of the home exemption calculated with the current rate for residential and apartment property be extended to those renters whose incomes fall below $50,000 or $75,000 and who can prove that they pay more than 30% of their income in rent. This would mean maximum rents of between $1,250 and $1,875 per month

would trigger a tax credit for that renter equal to the current rate times the $40,000 home exemption of about $150. Since the credit would go directly to the renter, there should be no reservation that the landlord will or will not pass on a cost savings such as proposed in Bill 3 (2006).

Bill 4 (2006) would increase the home exemption for those homeowners whose household income is 160% of median income or less. The amount of the home exemption would rise as household income declines such that the home exemption would rise from $100,000 ($40,000 for the basic home exemption plus $60,000 for this provision) for households with 160% of median household income to $240,000 for those with 20% of median household income.

Comment: The home exemption is ineffective in addressing an excessive burden of real property taxes as it is applied against the assessed value. Even a home exemption of $240,000 may not be sufficient to alleviate the tax burden imposed by the remaining assessed value after the home exemption is applied times whatever tax rate is applied for the family with a household income that is 20% of median family income. Measuring the actual real property tax bill against available family income is more precise in determining whether or not that taxpayer can afford the resulting tax bill.

Bill 10 (2006) is a short form measure that proposes to allow homeowners who qualify under a certain income threshold the option to pay a fee for City services in lieu of paying the real property tax.

Comment: This would be one of the most difficult of the proposals to administer as a determination must be made as to what would be the appropriate level for the fee to be to actually pay for the cost of City services used by the taxpayer. Will a determination be made of those services actually consumed or would this to be a fee in lieu of the real property tax levied without consideration of the cost of those services or how much of which services are being used by the taxpayer? Will the level of the fee bear any relationship to what the favored taxpayer will be able to afford? If the fee is insufficient to cover the cost of actually delivering that City service, the cost will be subsidized by all other real property taxpayers.

Bill 15 (2006) would establish a new class for real property tax purposes to provide a low-income homeowners category where the property has been granted a home exemption and where the income of all title holders of the land does not exceed $50,000.

Comment: Apparently this proposal would allow the setting of a tax rate that could be substantially lower than that set for other classes of real property. Not only would this proposal be a nightmare to administer because the income of the household would have to be determined and then the property would have to be designated to this category should the qualification be met, but it is doubtful that the lower tax rate could provide sufficient relief to the taxpayer depending on the size of the assessment and the income of the household. For example, a lower tax rate might be sufficient to benefit a homeowner with $49,000 of household income where the property is valued at $350,000, but would it be sufficient for the retired couple whose home is valued at $815,000?

Tax Relief Based on Length of Residency

Bill 5 (2005) would grant an additional amount of home exemption depending on how long the homeowner's tenure on that property has been. The additional exemption rises from an additional $80,000 for tenure of five but less than 20 years to $120,000 for tenure of 20 years but less than 40 years and to an additional $200,000 if tenure is 40 years or more. Since there is no prohibition drafted in this proposal, it would seem that the homeowner might also be qualified for the multiple exemptions because of age.

> ***Comment: Again, the amount of the home exemption proposed in this measure may or may not be sufficient tax relief for this type of homeowner. Just because the homeowner has lived on the property for a long period of time is by no means an indicator of how much that homeowner may need in property tax relief. A homeowner in Waialua may find the $200,000 generous where as the widow living in Kahala only on Social Security might find the additional $200,000 home exemption to be but a drop in the bucket.***

Bill 81 (2005) would allow homeowners to dedicate their homestead for a period of 10 years provided the property is qualified for and remains qualified for the home exemption during the 10-year period and the property is not sold or transferred during the 10-year dedication period. The increase in valuation of the property would then be limited to the change in the consumer price index of the previous calendar year. Breaking the dedication will result in payment of the taxes that would otherwise have been due and a 10% penalty. Exceptions include death of the owner and taking of the property by government.

> ***Comment: The county has had bad experiences with dedications as in the case of agricultural property. Unintended breaking of the dedication for other than death or taking by government will incur the penalties provided. For example, if the owner has to be moved to a nursing home or skilled care home, that possibility is not provided for in the exceptions and therefore the penalties would have to be imposed even though the owner may have had every intention to remain in the home. Further, no provision is made once the dedication period ends. Is the property revalued to market if the property dedication is not renewed? If the property is dedicated for another ten years, is the annual adjustment still limited to the change in the CPI? Like other limitations on the change in valuation, two identical properties may have two very different tax burdens and therefore shoulder different burdens for the cost of City services. Those properties that cannot avail themselves of the dedication provision will end up subsidizing those who are so favored.***

Bill 5 (2006) would cap the annual increase in valuation of properties granted the home exemption depending on the length held by the title holders from 5% for those properties held between five and ten years with declining percentage increases in valuation until the property held 30 years or more would enjoy no annual increase in the valuation of the property. The cap would not apply to any increase in the fair market value of the property resulting from an action by the owner - which might mean an improvement is made to the property or if the property is sold or transferred. This latter provision is somewhat unclear as one might ask if the cap would still apply if the property was held beyond five years after the action by the owner was taken.

> ***Comment:*** ***There is nothing magical about how much the valuation of property should increase depending on how long the property was held by the titleholder. Further, there is no correlation between the length the property is held and the ability of the titleholder to pay his or her fair share of property tax. In fact, if one accepts that after 30 years the mortgage on the home is paid off, those owners are probably in a better financial condition to pay more property taxes than the young couple who has just purchased their first home for $400,000 to absorb market increases in their home's valuation. Again length of tenure on the property is no indication of the taxpayer's ability to pay the real property tax burden.***

Broad-Based Tax Relief

Bill 67 (2004) would double the current exemption for the blind, deaf and totally disabled from $25,000 to $50,000.

> ***Comment: Again, physical disability and age are not indicators of the taxpayer's ability to pay his or her share of the real property tax burden. One cannot just assume that because a person is disabled that the person is poor or needy. Case in point is that the City grants those with disabled decals free metered parking yet one only has to count the number of Mercedes, Lincolns and Ferraris parked in metered stalls with the disabled decal. Is that a waste of City resources that other drivers, or in this case other real property taxpayers, must subsidize?***

Bill 1 (2005) would double the current home exemption to $80,000 and therefore increase the multiple home exemptions granted because of age.

> ***Comment: The home exemption is totally irrelevant to the taxpayer's need for relief as it may not be sufficient to overcome the increases in valuation that have prompted this spate of tax relief measures. Further, when it is granted to someone who has the ability pay his or her fair share of the property tax burden it comes at the expense of the homeowners who truly need additional relief. Thus, for those homeowners who have substantial income, the increased home exemption represents a waste of City resources.***

Bill 1 (2006) would grant a one-time tax credit for the upcoming fiscal year since it is too late to grant an increased home exemption for valuations which will form the basis of the tax bill for the next fiscal year. The credit would be applied against the homeowner's 2006-2007 tax bill and ranges in amount with an equivalency of a $60,000 home exemption for those under age 55 to a $230,000 home exemption for the homeowner who is 75 year and older. The homeowner must have qualified for the home exemption in order to receive the credit.

> ***Comment: Again, this credit is in lieu of the home exemption and the amounts of credit have no bearing on a specific taxpayer's ability or inability to pay the real property tax and in some cases may be insufficient to offset the burden created by the rise in valuations. Those who may not need any assistance will also be able to claim the one-time tax credit.***

Bill 2 (2006) would increase the value of a property granted the home exemption to the greater of 10% or 150% (1.5 times) of the annual change in the Consumer Price Index (CPI). The limitation would not apply to increases in valuation of the property caused by actions of the owner, property sold or transferred in the previous year or those not granted the home exemption.

> ***Comment: If the CPI rises by only 3%, as is expected this year, the greater of 10% would apply to the change in the valuation of the favored property. One must ask if the real estate market slowed and actual valuations check in at 7% on average, will homeowners be happy about an automatic 10% increase in their real property assessment? Conversely, if inflation rages at 8% for the year which means the change in value would be 12%, but because of high interest rates imposed to control inflation causes a cooling in the real estate market such that actual values only come in at 5%, will homeowners be happy with the 12% increase in valuations? The effects of this proposal are so arbitrary.***

Bill 12 (2006) would appear to recalculate the rate to produce the same tax bill for the real property owner when the new assessments are sent out by the director of finance, allowing for an adjustment for inflation. The proposal allows the rate to be subsequently increased or decreased by the council.

> ***Comment: This proposal is very similar in effect to what was known as the Florida law when the real property tax policy was set by the state. Under the Florida law, the average rate had to be recalculated so that the sum of the valuations for a county would produce the same amount of revenue as property tax produced in the previous year. Taxpayers could then ascertain how much the council was raising or lowering the tax rate based on the recalculated average rate. This might not be a bad idea to resurrect so that real property taxpayers could understand whether or not elected officials were raising or lowering their taxes and by how much. The rate under this proposal would be different for each real property owner as the amount of increase would differ by parcel. It might be better to go back to the process of the Florida law as it would take into account the larger picture of how much values in total increased and therefore could be better compared to the average rate to be adopted by council.***

While all of these proposals are well intended, they attempt to alleviate the property tax burden for a variety of constituencies and most have little to do with the taxpayer's ability to pay with the exception of Bill 80 (2005). We would recommend that of all the proposals, committee members give that proposal the most serious consideration as it is tied to the taxpayer's tax bill and the taxpayer's ability to pay. The other proposals, from increased home exemption to tenure of holding the property, are nothing but gimmicks that will not provide the needed tax relief.

Finally, all these measures address residential occupation of the property. We must underscore that non residential property values also soared this past year. Unless relief is found for those properties, the cost of higher property taxes will have to be recovered as part of the operating expenses of businesses that occupy these properties. That cost will be past on to the very constituents who you are trying to protect with all of these proposed measures. If the additional cost cannot be passed on, then those businesses will cease to do business in Honolulu and along with those closures will go the jobs that your constituents need to pay the taxes on their homes. So in the end, the most simple solution that may not be elegant or politically popular is to reduce spending to the point where true tax relief can be realized by dropping property tax rates.

Thank you for this opportunity to present comments on the various real property tax relief measures and we stand ready to field any questions you may have about our comments.

Very truly yours,

Lowell L. Kalapa
President